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IN THE

United States Circuit Court of Appeals

For the Ninth Circuit

SCANDINAVIAN-AMERICAN BANK,
a Corporation,
Petitioner and Appellant,

v.

R. L. SABIN, Trustee of the Estate of
D. Sondheim, Bankrupt,
Trustee and Respondent.

ADDITIONAL BRIEF FOR APPELLEE.

Petition for Revision of and Appeal From a Certain Order and Judgment of the United States Circuit Court for the District of Oregon.

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BOYER PRINTING COMPANY, PORTLAND, OREGON

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FOREWORD.

At the oral argument of this case, counsel for appellant tendered a five-page typewritten document embodying after-thoughts, which the Court, upon request, authorized him to print, but inasmuch as it had not theretofore been exhibited to Appellee, and for the further reason that Appellee from previous experience

with Counsel for Appellant knew the range which would be taken, and that the inch would develop into the ell, the Appellee respectfully requested the Court to extend him the right to file an Answering Brief, if he so desired, which request was granted. The five pages, as anticipated, accordingly blossomed into a 39-page *post bellum* "Reply Brief" (the original Brief being 26 pages) in which will be found a *melange* of warmed-up excerpts from the original Brief with here and there new contentions and new cases not originally urged or cited so that the Appellee would have been afforded an opportunity to answer, though the scope of the controversy was thoroughly familiar to Appellant when the original Brief was filed. If the Appellant fails after this Brief is filed to forward to San Francisco in the form of letters, memoranda, or what-not, another set of disputations and heterodox authorities supposed to sustain them, he will break a precedent with which those in touch with the history of this case, before the Special Master and before the District Court, are despairingly familiar.

There are only two phases of the Appellant's most recent discussion which are worthy of extended rejoinder. As to the others we shall be extremely brief, preserving, however, for clarity the Appellant's divisions and subdivisions.

I.

Did the title "Remain" in the Bank?

Conditional sale or trust?

In our answering Brief we demonstrated the fact that the settled law of this jurisdiction condemns the transaction in the instant case. Appellant replies by citing a decision in another circuit (Dunlop v. Mercer, 156 Fed. 549) expressly recognizing the truth of our observation as to the law governing this case, but containing the further statement which is, *quoad* this discussion, interesting, rather than important, that the law is different in some other jurisdictions.

The distinction asserted by Appellant to exist with regard to "possession" is fully discussed hereinafter under a more appropriate heading.

The Appellant avers that the appellee is "mistaken" in saying that Sondheim had unlimited power to dispose of the merchandise, and was not restricted in his utilization of the proceeds of the sale thereof. Our statement is based upon the Findings of Fact of the Special Master from which no appeal was taken and upon the view of the facts expressed by the District Court, and it will serve no useful purpose to point out again that it was a conceded fact that Sondheim was left in possession of his stock, conducted his business as before, deposited the proceeds of sales to his own credit, commingled the funds received from other sources and that

the account was at all times subject to his check, etc. We assume therefore that the *ipse dixit* of the Appellant to the effect that we are "mistaken" will not weigh heavily with the Court.

Throughout Appellant's Reply Brief, and his original Brief for that matter, he proceeds upon the unwarranted assumption that the claim of invalidity of the chattel mortgage in this case is based solely on the conduct of the parties, and that there is no question, eliminating this important feature, as to the validity of the instrument.

The conduct of the parties as shown by the Findings of Fact and the decision of the lower Court, are so flagrantly objectionable that we considered it unnecessary to devote much attention to the language of the instrument, which is after all of secondary importance, but if this case had to be determined wholly upon the question of the language of the instrument we would assert, with confidence, that it is void on its face, in Oregon, in that by the express terms thereof it attempts to assert a lien upon a store full of assets and yet gives to the mortgagor the right to remain in possession of them, sell them *ad libitum* and retain one-half of the proceeds for his own use. It is believed to be unnecessary to cite authority for a proposition which seems so axiomatic.

Leaving, however, the question of the language of the chattel mortgage, the Appellant at pages 5 and 6 of its Reply Brief makes a labored attempt to answer our point that the court is more interested in the manner in which the transaction is carried out than in the lan-

guage of the agreement. We are assured by Appellant that nothing prevented a levy of attachment by the creditors of Sondheim. One risks an attack of vertigo in attempting to follow the mazes of this particular argument, but reduced to its lowest terms it seems to amount to a reproach to the creditors for negligence in failing to suspect the sedulously guarded secret arrangement between Sondheim and Appellant, and in trusting to appearances and particularly in permitting themselves to be lulled into security by parties who now complain of this child-like faith.

As soon as Sondheim skipped and conditions became suspicious, the creditors acted at once, but the Bank having quicker and better means of information got its man to the premises an hour ahead of the sheriff, and for the first time the creditors were confronted with the information that all of the stock was claimed by the Bank because of a secret lien given it some weeks before, in consideration of its advancing less than one-half of the purchase price. If the creditors under these circumstances have been negligent or have omitted anything which vigilance would have demanded, Appellant has failed to point out the respects in which the laches inhere.

But, naively claims the Counsel for the Bank, Sondheim's possessions were "increased," not diminished by it, and therefore this secret and fraudulent preference should be sustained. We ask the Court to examine the validity of this argument in the light of the following considerations overlooked by Appellant:

1. Sondheim's possessions were also "increased" to the extent of thousands of dollars' worth of goods entrusted to him by those whom Appellee represents, upon the faith of Sondheim's apparent ownership of the business conducted by him.

2. The Bank in actual practise permitted Sondheim to check upon the funds arising from the sale of the secretly mortgaged goods at his pleasure, thus enabling him in the three weeks' time to dispose of thousands of dollars' worth of assets and skip with the proceeds several days before it took possession. Just how beneficial this "increase" was, is not apparent.

3. The Bank is not claiming the return of the $2600 advanced by it, but of $5200, representing also the old indebtedness of $2600. The Pallay stock to aid in the purchase of which the $2600 is claimed to have been advanced cost Sondheim $5800. Sondheim, therefore, used $3200 additional money, assets for the general creditors, which the Bank now wishes to grab under the plea that it "increased" the assets.

4. The Special Master and the District Court denying the validity of Appellant's lien, found it unecessary to pass upon the question of payment; but as a matter of fact, of the $2600 advanced $2,000 was recovered by the Bank before the institution of this suit (Transcript of Record, pages 54 and 58). It is true that after the adjudication in bankruptcy Appellant attempted to jockey the credits but the illegality of this ex post facto juggling is palpable.

And then Appellant, lest the Court forget the quotation from Black on page 14 of its original Brief, sets it out *in extenso* again at page 7 of the Reply Brief, oblivious of the fact that the quotation repudiates Apellant's contention in that the text-writer is careful to qualify his approval of the trust certificate doctrine by the condition *"binding him to pay over the proceeds of such sales as fast as received until the advances are repaid,"* which condition is the vital and all-important consideration omitted in the instant case.

III

IS THE CONTRACT VALID CONSIDERED AS A CHATTEL MORTGAGE?

The assertion was made in Appellant's original Brief that under the laws of the State of Oregon a chattel mortgage in which in terms or in operation, the mortgagor is permitted to remain in possession of a shifting stock of goods and use the proceeds, or part of them, is not void. This matter was thoroughly briefed by us before and we shall not weary the Court with a repetition of the citations showing the invalidity of such a transaction to be clearly established in Oregon.

This Court has already indicated in Peterson v. Sabin, 214 Fed. 234, that its understanding of the Oregon decisions is that such a transaction is void, independently of the question of fraudulent intent of the parties. But the Appellant has found two more cases which he cites at page 12 of the Reply Brief.

Appellant neglects, however, to state that neither of these cases deals with a shifting stock of goods. Both of them as a matter of fact were decided before the enactment of Section 7407, L. O. L., which came into being for the first time in the Oregon General Laws of 1893, page 30. In Appellant's quotation from the first of these cases, Marks v. Miller, 21 Ore. 317,. he garbled the language of the court in such a way as to make it appear that in referring to the "earlier decisions" the Oregon Court is speaking of its own decisions construing its own statute, whereas a reference to the case will show that it is speaking of decisions generally, in other jurisdictions.

In the Marks case there was a delay of three days in recording the mortgage. The Court, discussing the presumption of fraud which arose therefrom, points out that it may be rebutted (page 323) "by showing that it was made on a good and valuable consideration and was bona fide; *that such possession was fair and consistent with the terms of the mortgage, and the nature of the transaction.*"

In the instant case the possession was found to be utterly *inconsistent* with the nature of the transaction and with the terms of the mortgage in that neither the instrument itself nor the parties in carrying it out applied the proceeds in liquidation of the mortgage debt.

The other case cited by Appellant—Davis v. Bowman, 25 Ore. 189, deals merely with the question of priorities between mortgagees and arose at a time when a mortgage was not declared to be invalid because of failure to record. The Court points out that by record-

ing the mortgage, the mortgagor could be enabled to pledge his chattels as securities and "retain the possession and use of them in a *reasonable* way," and the mortgagee be relieved from the burden of proving the bona fides of the transaction. It is manifest from this language that the presumption of fraud cannot be rebutted by the use of them in an *"unreasonable"* way, such as, for instance, the absolute disposition of them by the mortgagor and appropriation of the proceeds with the consent of the mortgagee.

Again and again, as in the original Brief, the Appellant talks about its "good faith." This Court pointed out in Peterson v. Sabin, supra, that good faith was not the controlling consideration, and the U. S. Supreme Court expressly so held in Knapp v. Trust Company, 216 U. S. 545. The finding by the Special Master as to the absence on the part of the Bank of an express intent to defraud the creditors was qualified, as we pointed out in our Brief, at pages 19 and 20 (Transcript of Record, p. 41). An additional fault which inheres in Appellant's argument in this regard is its attempt to test the question of good faith by examining the motives of the Bank. The creditors are also interested in Sondheim and what Sondheim was enabled to do by virtue of his arrangement with the Bank.

As Judge Deady pointed out in Catlin v. Currier, Fed. Cas. No. 2518:

> "Such use of the mortgaged property by the mortgagor is utterly inconsistent with the idea of giving a pledge of security to

the mortgagee. In legal effect it is a sham, a nullity—a mere shadow of a mortgage, only calculated to ward off other creditors—a conveyance in trust for the benefit of the person making it, and therefore void as against creditors. * * *

But it is said by the counsel for defendant, that the question of "fraudulent intent," under the statute is a question of fact (Code, Ore. 657), and that, as the court has found as a matter of fact, the defendant acted in the premises without any intent to defraud anyone, the only conclusion of law proper to be drawn from the facts is in favor of the validity of the mortgage.

This argument, it seems to me, is based upon two erroneous assumptions.

1st. That the fraudulent intent of which the statute speaks as sufficient to void a mortgage, is in any case, the intent of the mortgagee; and 2nd, that the question of "fraudulent intent" is not involved in this case at all. * * *

As to the second error of the argument under consideration, it is sufficient to say, that such a mortgage or conveyance as this —a conveyance in trust for the party making it—is declared void as to creditors, as a matter of public policy, without reference to the intent of the parties thereto. The law assumes absolutely, and beyond doubt correctly, that in no circumstance can such a transaction be upheld in justice to creditors. In this case, whatever may have been the intention of the parties, the law for the protection of the general cred-

itors of the debtor, declares the so-called mortgage void, because made in trust for Daly."

* * * * * *

Appellant discussing the nature of the change of possession required by the Oregon statute calls attention to the case of Rule v. Bolles, 27 Ore. 368, which he claims as authority for the statement that the presumption of fraud from failure to record or to deliver immediate possession ceases as soon as possession is transferred.

The mental astigmatism of Appellant in this regard is curious. He apparently loses sight entirely of the fact that possession of the assets covered by the chattel mortgage was never transferred. The Bank got hold of *what was left* after Sondheim had sold, with the Bank's consent, as much as he pleased and pocketed the money. Taking possession of what little is thus left is a very different proposition from the one before the Oregon Court in the case of Rule v. Bolles on which appellant relies. That case did not involve any question of a shifting stock of goods which is unique and distinct. All of the property covered by the conveyance in the Bolles case was transferred to the possession of the vendee, and thus, if the transaction was a fair one, the equities of the creditors were preserved. The vice of the instant case which Appellant cannot or will not see, is that had the Bank procured a valid chattel mortgage from Sondheim to the extent of the $2600 advanced by it, and proceeded to sell the stock in such a way as

to apply all of the proceeds in liquidation of its lien the creditors would have procured the equity over and above the amount of its advance, whereas it chose instead to take what it calls a mortgage, let Sondheim use the mortgaged goods as he saw fit, and when the house collapsed, grabbed what little was left and attempted to hold it for nearly the entire amount of its original claim.

In the Bolles case none of the property had been dissipated. Possession had passed, the jury found, several months before the attack, and Judge Bean expressly pointed out that the statute referred to by Appellant was not involved because the change of possession was found to have been an immediate one.

* * * * * *

At page 21, et seq. of its Reply Brief, Appellant, with renewed energy, comes back to Orton v. Orton, and Bremer v. Fleckenstein and endeavors again to distinguish the facts in the instant case. We shall not weary the Court with another summary of the flagrant manner in which the transaction was carried out. In this connection, however, Appellant makes the gratuitous statement that the evidence shows that Sondheim "deposited *all* the proceeds realized from the daily sales in the Bank." This statement is utterly without foundation, though it would make little difference if Sondheim did make such deposits inasmuch as the Appellant admits he was permitted to *check on the account as he saw fit. In what way would the creditors be benefited by Sondheim depositing the proceeds and the next day drawing it out in cash and skipping?* Does the fact

that Sondheim made three payments to the Bank on account, *not* under the terms of the chattel mortgage, but under a subsequent and different verbal arrangement, alter the situation? Appellant, however, thinks that in a case of this character if the mortgagee pays the mortgagor a few dollars the doctrine of Orton v. Orton and Bremer v. Fleckenstein is avoided.

We are somewhat surprised that Appellant even admits (Reply Brief, page 23):

> "Without this requirement of weekly payments, the agreement considered as a chattel mortgage, clearly would be one for the benefit of the mortgagor and the reason for holding it void against attaching creditors would be apparent."

That admission renders it unnecessary to argue the matter further, inasmuch as all the Appellant can claim after making it, is the fact that its conduct varied in *degree* of vice as to the creditors from the conduct in Orton v. Orton and Bremer v. Fleckenstein, and not that it varied in *kind*.

Appellant continues on the same page, arguing that if the mortgagor is left in possession with the right to sell the goods, but providing for weekly payments which will extinguish the indebtedness within a reasonable time, the mortgage is clearly valid. Appellant neglects to give us the benefit of his views as to just what sized weekly payments should be demanded and as to just what is a reasonable time. The mortgagor might do as Sondheim did, conduct sales, and

get rid of large quantities of goods in bulk within three or four weeks. Or in the case of a store in a remote section, sales in three or four weeks might amount to very little. We do not therefore blame Appellant for qualing before the task of a definite statement as to how much the mortgagor should be allowed to retain for his own use, and how long a time he should be permitted within which to pay his indebtedness before the transaction comes within the inhibition of the doctrine of Orton v. Orton.

In law, equity and good conscience there is but one condition under which a mortgagor can be left in custody and control of property covered by mortgage, even though *recorded,* and that is that every sale shall be accounted for and, less the reasonable expense necessarily incident thereto, applied in reduction of the mortgage debt so that the equity of general or subsequent creditors in the surplus will not be impaired. To permit the debtor to retain 1/2 or 1/3 or 1/4 of the proceeds free from the mortgage claim and yet immune from attacks of general creditors who are warded off by the lien, may be only 50 per cent, or 33 1/3 per cent or 25 per cent as fraudulent or damaging but we are cited to no authority justifying Appellant's dogmatic assertion as to the magic of such percentages.

To clinch his argument in this particular Appellant drags in an Alabama case discovered in the archives—Adkins v. Bynum, 109 Ala. 281, which held that a distinction exists in Alabama with regard to transactions of this character, in a case in which the *entire* stock and purchase price was advanced by the mortgagee, on the

ground that no creditor is injured. We are not particularly concerned with the soundness of this doctrine, inasmuch as it is conceded in the instant case that the bank advanced only $2600 out of a total purchase price of $5800. The Alabama Court said in addition to the sentence quoted by the Appellant: "It (the mortgage) is not a conveyance of property out of which the creditor could have realized his claim, or some portion thereof."

Surely Appellant will not contend that the creditors could not have realized their claims or some portion thereof out of the $3200 of his own money advanced by Sondheim in purchasing the Pallay stock.

* * * * * *

One of the two points made by Appellant calling for serious consideration is that set out under heading "C" on page 27 of the Reply Brief, as follows:

> "Possession of mortgaged property by a mortgagor under an unrecorded chattel mortgage before the lien of any creditor attaches, makes such a mortgage good against every one."

We cited in our Brief (page 29) the case of Schaupp v. Miller, 206 Fed. 575, decided by District Judge Bean which distinctly and unequivocally holds that the taking of possession under a mortgage like the instant one before the intervention of bankruptcy, but after its execution and delivery and after the mortgagor has been allowed to remain in possession and dispose of part of

the stock, will not avail the mortgagee when the instrument is attacked.

No valid difference between that case and the instant case exists and none is pointed out by Appellant. Judge Bean recognized that the question is not free from difficulty and that there are other jurisdictions in which a different doctrine is announced.

We shall proceed to an examination and discussion of the cases cited at page 28 and at other points in Appellant's Brief, under the claim that they establish the fact that the better rule, both upon reason and authority, is that such taking of possession cures invalidity. Appellant takes comfort in the fact that the decision of Judge Bean in Schaup v. Miller is after all only the decision of a district court. We believe that this court will not consider as of merely passing moment the fact that Judge Bean, weighing and determining the question in the light of the law of the State of Oregon, brought to the consideration of the case in addition to the ability which commands such universal respect, a long experience upon the Supreme Court of the State of Oregon and an active participation in the decisions upon questions kindred to that at issue.

The first case cited by Appellant, that of Etheridge v. Sperry, 139 U. S. 277, has not so far as we can find the slightest reference to validation by *possession.* The Court dealing with the *recorded* chattel mortgage simply announced the well-known principle that it would follow as to its status, the ruling of the Courts of Iowa where the case arose.

The next citation—Johansen Bros. Shoe Co. v.

Alles, et al., 197 Fed. 278, is claimed by Appellant to be "squarely in point." A pertinent paragraph from the court's opinion explaining the basis of the decision will disclose just how "squarely in point" it is: (It being remembered that in the instant case the mortgage was *never recorded* and no creditor had any intimation of it.)

> "The mortgage in this case *being of record,* imparted, according to the laws of the State of Missouri, *notice* to the public, and, of course, to the *creditors* of the mortgagor, of all of its provisions. They at any rate had constructive knowledge of the mortgage and of its provisions, equally as certain of being real as the mortgagee's constructive fraud was certain of being actual. They therefore knew that the mortgage was good as between the parties, and knew that they might proceed against it and fix a lien upon it for their claims superior to the right of the mortgagee if they desired to exercise the requisite diligence to do so. They knew that they must act if at all before the mortgagee should exercise his right to take possession of the property. Their failure to do so indicates their confidence in the honor and integrity of their debtor, and emphasizes what is apparent in this case, the solvency of their debtor and the actual good faith of his transaction with the mortgagee. There are, therefore, no equitable considerations which in any manner incline us to ignore the doctrine of the state of Missouri which makes for the benefit of the mortgagor in this case."

In re Marengo, etc., 199 Fed. 480, next cited, is not in point so far as we can ascertain, but to the extent that it is at all instructive, it is apparently adverse to Appellant's contention.

In re Harnden, 200 Fed. 177, the mortgage was as in the Johansen case, *recorded*, and the Court expressly bases its decision on the ground that in New Mexico such a mortgage is not void as a matter of law.

In Garner v Wright (Ark.), 6 L. R. A. 715, a shifting stock of goods was not involved. The property was intact and the procedure was countenanced by the Arkansas law.

In Noyes v. Ross (Mont.), 47 L. R. A. 400, no question of taking possession was involved. The Court simply announced a rule differing from that of Oregon as to the validity of instruments preserving the rights to mortgagors, and argues that *recordation* lessens the opportunity for fraud.

In Read v. Wilson, 22 Ill. 380, the mortgage was *recorded* and possession taken within a few days, the attack following six weeks later.

In Thompson v. Fairbanks, 196 U. S. 516, the mortgage was *recorded at once,* and the Supreme Court pointed out that:

> "Instead of taking possession of the time of the execution of the mortgage, the defendant had it *recorded* in the proper Clerk's office, and the record stood as notice to all the world of the existence of the lien as it stood when the mortgage was executed, and that the defendant would

> have the right to take possession of property subsequently acquired, as provided for in the mortgage. The bankrupt was, therefore, not holding himself out as unconditional owner of the property, *and there was no securing of credit by reason of his apparent unconditional ownership. The record gave notice that he was not such unconditional owner. There was no secret lien.* * * * *"*

Appellant, however, expresses its greatest faith in Hauselt v. Harrison, 105 U. S. 405, which it claims to be "decisive" on this phase. In thus viewing the decision the Appellant overlooks the fact that *no element of fraud was present to vitiate the transaction.* The lien was an *equitable* one arising from the fact that the lienor was placed in possession of the goods by the lienee, and the only basis for the claim of invalidity was as in the Flatland case, the failure to record. Where, however (at least in Oregon), the mortgagee by the instrument or by the conduct under it enables the mortgagor to retain the power of disposition and to appropriate the proceeds, the transaction is *fraudulent* and void, and not merely defective in some formality like recordation. This is pointed out in many cases, some of which will be hereinafter referred to, but it is unnecessary to go beyond the particular opinion to illustrate this fact, because the Supreme Court evidently had the distinction in mind from its reference in the Hauselt decision to the case of Yeatman v. Savings Institution, 95 U. S. 764, the opinion in which case is quoted to the following effect:

> "*Except* in cases of attachments against the property of the bankrupt within a prescribed time preceding the commencement of proceedings in bankruptcy and *except* in cases where the *disposition* of property *by the bankrupt* is declared by law to be *fraudulent* and void, the assignee takes the title subject to all equities, liens or encumbrances, whether created by operation of law, or by act of the bankrupt, which existed against the property in the hands of the bankrupt."

The remaining cases cited by Appellant on this phase are typified by the strongest of them—Cameron v. Marvin, 26 Kansas, 612, from the decision in which by Mr. Justice Valentine, the Appellant quotes at length.

In the Cameron case the mortgagor before the filing of any lien voluntarily delivered possession to the mortgagee and this was held by the Kansas Court to suffice. The Court expressly declined to pass upon a question like that in the case at bar where possession was *not* voluntarily turned over by the mortgagor but was taken by the mortgagee after the mortgagor had become a fugitive, and taken expressly under the powers claimed to be conferred by what we contend to be a void instrument.

(The Bank's cashier testified that becoming alarmed he sent a representative to the Sondheim store to take possession under the authority of the mortgage, and that Sondheim's employees did not resist but recognized the right of the Bank. Manifestly this is not equivalent

to a voluntary delivery or pledge by Sondheim. No testimony was introduced to show that Sondheim's agents at the store had any such extraordinary authority as to dispose of all of the assets of their principal.)

However, instead of indulging in our own comments on the Cameron case, we will set out an explanation of its rationale by Judge Valentine himself in a later case, that of Rathbun v. Berry, 49 Kan. 375; 33 A. S. R. 389, in which case possession was obtained as in the case at bar by the mortgagee in the absence of the mortgagor, and from the mortgagor's wife. Judge Valentine after pointing out that the mortgage was invalid, continues:

> "But it is claimed that the plaintiff as mortgagee obtained the possession of the goods before any of the same were sold, and that such possession cured all irregularities and rendered the mortgage valid. The possession, however, was not procured by any delivery of the goods by the mortgagor or with his consent. The plaintiff took the possession of the property without the mortgagor's consent and only by virtue of the authority given by this void mortgage—not void because it had not been deposited with the register of deeds; not void because of a want of notice to the mortgagor's creditors or subsequent purchasers or encumbrancers; not void because of an insufficient description of the mortgaged property; not void because of a want of a renewal affidavit, and not for any other irregularity which was not in contravention of good morals or public policy, *but void because of a stipulation*

contained in the mortgage which must be considered as against public policy, if not in contravention of good morals, and as tending to hinder and delay creditors in the collection of their just claims, and thus hindering and delaying of creditors without any good reason therefor, and providing for such a disposal of the property as must necessarily render the mortgage itself substantially nugatory. What the effect of the delivery of the possession of the mortgaged property by the mortgagor to the mortgagee, or a taking of the possession of the property by the mortgagee with the consent of the mortgagor would be, it is wholly unnecessary in this case to decide for nothing of that kind took place in this case. It was not shown that the mortgagor ever gave his consent otherwise than by the mortgage. There is no evidence tending to show that the mortgagor's wife had any authority from the mortgagor to deliver the property to the mortgagee, and it cannot be supposed that she had any such authority merely because she was his wife. A taking of the possession of mortgaged property by the mortgagee, to be sufficient to cure all irregularities and to make the mortgage void, must be either under the authority of a written instrument valid and sufficient for that purpose or under some valid parol consent of the mortgagor. Such was not this case."

* * * * * *

While this Brief is attaining proportions which we deprecate, we believe it may lessen the labors of the Court if we here set out a few cases selected from a plethora on the subject of the effect of such a taking

possession where the mortgage, as here, is fraudulent as a matter of law.

The leading case on the subject and the one cited wherever the subject is carefully considered is that of Blakeslee v. Rossman, 43 Wis. 116. The opinion is so instructive and convincing that we find it difficult to content ourselves with such excerpts as:

> "Apparently apprehensive of its validity, the respondent tried to purge his title of the fraudulent mortgage. He undertook to show that the mortgagor voluntarily surrendered possession to the mortgagees, his creditors, without respect to the mortgage. Whether he claimed such surrender as a payment or as a pledge, is left uncertain. And the very uncertainty goes to disprove either. * * * * We do not hold that the holder of a chattel mortgage may not relinquish his right under it, and accept the mortgaged goods from the mortgagor, in payment of his debt or as a pledge. Such a transaction might be upheld in a proper case. But we do hold that such a shifting of title must be open, express and explicit; as open, express and explicit as the mortgage itself; and that one who takes possession of chattels, apparently under a mortgage, cannot, when the mortgage fails him, shift his right of possession, by vague evidence of implied understanding, to payment of his debt or to a pledge for it. Both debtor and creditor must expressly be parties to either payment or pledge. And either must be established by the acts of the parties at the time, as expressly and satisfactorily as payment or pledge in any other case. * * * *

"Without expressly saying it, the charge seems to imply, as was argued here, that possession of the mortgagees, under the mortgage, would operate to cure the fraud imputed to it by law. *It is a novel and startling proposition that possession under an instrument of title can be better than the instrument of title itself.* * * * As against creditors, the paper is void from the beginning, and remains void always. No change of possession can purge it of the fraudulent provision, or operate to make that valid which was void before. Before and after possession taken, the title of the mortgagee rests equally on his mortgage, and the question between him and creditors of his mortgagor is equally upon the validity of his paper title. The title accompanies the possession and enters into it, and the possession rests on the title. The mortgagee's possession, under the mortgage, is just as good or as bad as the mortgage itself. And no court possesses power to transmute a void mortgage into a valid pledge."

And said Sargent, J., in the case of Janvrin v. Fogg, 49 N. H. 340:

"The instructions, upon this point, were erroneous; or, if it be held that this mortgage may be good and valid, as between the parties, but void as to creditors, on account of the fraudulent intentions of such parties towards such creditors, then to hold that as against such creditors, the possession of the property, taken by virtue of the mortgage, might be rightfully held as a pledge, *would be giving effect to the*

> *fraud, and enabling this plaintiff to hold the property, under a contract, which he did not make, when he could not hold it under the contract which he did make.* This substitution of one contract for another, would enable the plaintiff to take the full advantage of his fraudulent act."

The difference between the instant case and one like the case of Hauselt v. Harrison is also well illustrated by the case of Zartman v. First National Bank of Waterloo (N. Y.), 109 App. Div. 406, where it is said:

> "It is urged, however, that inasmuch as the defendant acquired possession and dominion over the property before any levy was made or judgment was obtained, equity will sustain the validity of the lien. The defendant, representing the bondholders, was responsible for the agreement, which permitted the organ company to sell and dispose of the property without restriction and to use the income and profits like any owner. The defendant allowed this plenary authority to continue undiminished until the company became insolvent and until other creditors were pressing for their pay. Then it asserted its ownership to all the property to the exclusion of these unsecured creditors. There is no reason for equitable interference to aid the defendant in retaining this property when its own remissness has operated to the disadvantage of other creditors. Equity is often invoked to aid a just claim, though technically invalid, but not in a case of this kind. * * * *"

Same case on appeal 189 N. Y. 267, 82 N. E. 127.

And Mr. Justice Shiras, in Circuit, points out even more distinctly that the doctrine of Hauselt v. Harrison has no application to mortgages void, not for want of recordation, but because *fraudulent* in law. Said that Judge, in Wells v. Langbein, 20 Fed. 183, after condemning a mortgage under which the mortgagee retained possession of a shifting stock of goods:

> "The fraud existing in the mortgage itself vitiates all steps taken under it. * * *
>
> Without citing further authorities upon the same proposition, it seems to me clear that the cases last named announce the true rule. If the mortgage under which possession is taken, is fraudulent and void as to creditors, then the effort to enforce it by taking possession under it cannot purge it of the existing fraud, nor render valid as against creditors that which the law, on grounds of public policy, declares to be fraudulent, and therefore void. *When a chattel mortgage, bill of sale, or other like instrument is imperfect from insufficient description, or because the property is not then in existence, or because the mortgagee did not promptly take possession, or record the mortgage, or for any reason not bottomed on fraud, then taking possession may render complete and valid that which was before incomplete,* but when the validity of the conveyance is caused by the fact that it is a *fraud* upon the rights of third parties, upon what principle can it be held that enforcing a fraudulent mortgage, by taking possession under it, shall have the

> effect of validating it? The title and rights of the mortgagee are based upon the mortgage. He enters into possession under and by virtue of the mortgage. If the mortgage is void as to creditors by reason of fraud, the title and possession based thereon must, if attacked by creditors, fall with the foundation on which they rest. Any other rule would in most cases enable the parties to the fraud to reap the benefits of their fraudulent practise, as in that case a debtor could give a chattel mortgage upon his property to a favored creditor, or friend, remain in possession, continue to sell in the usual course of trade, use the proceeds for his own purpose, and still protect the mortgage from successful attack by being sufficiently on the alert to hand over possession to the mortgagee just before the injured creditors make a levy upon the property."

In Stein v. Munch, 24 Minn. 390, the chattel mortgage was invalid as here and the mortgagee subsequently, as here, took possession. Said the court:

> "From this it follows that it is not in the power of the mortgagee or his assigns to remove the original taint of the mortgage and make it good by taking so much of the mortgaged property, as has not been sold by the mortgagor, into possession under and by virtue of the mortgage."

In Mandeville v. Avery, 124 N. Y. 276, it was urged that the objection of invalidity was not available when

possession had been obtained by the mortgagee before the validity was questioned. But the Court answered this contention as follows:

> *"There is nowhere any suggestion in the evidence or findings that the mortgage was waived or abandoned or that the debtor had voluntarily delivered the property to Avery with authority to sell it.*
>
> *"Everything that was done was pursuant to and under the mortgages. Avery could not and did not claim to have received the property or the proceeds of the sale in payment of his debt as the voluntary act of the debtor, but as mortgagee.*
>
> *"He cannot therefore assert against the claim of other creditors the honesty of his own debt. The mortgage being void, all proceedings under it were void and although he may possess an honest claim, he cannot retain property obtained by him under a fraudulent mortgage against a pursuing creditor."*

In the case of Madson v. Rutten, 16 N. D. 281, 113 N. W. 872, the Court referring to the cases of Cameron v. Martin, supra, and Francisco v. Ryan, a case also cited by Appellant, said:

> "Most of these cases merely announce the rule that where, after the execution of a mortgage, which is void as to creditors, the parties thereto make a new agreement under which possession of the mortgaged property is turned over to the mortgagee, a valid lien is thereby created. None

> of them go to the extent of holding, aside from the cases from Illinois and Missouri, that the mere taking possession of the property by the mortgagee for the purpose of foreclosure without the express consent or agreement of the mortgagor has the effect of validating such instrument. *The great weight of authority,* and, as we think, the *better reasoned cases,* hold that the mere fact that the mortgagee in such a mortgage takes possession of the property under the terms of the instrument for the purpose of foreclosure will not operate to validate the same, and that the creditors may pursue the property in his hands."

From these selected cases it will be seen that the Appellant is somewhat rash in asserting that the weight of reason and authority endows possession with the power of sanctifying fraud in a mortgage transaction. It is evident that many respectable courts agree with Judge Bean in the conclusion reached by him in Schaupp v. Miller, 206 Fed. 255, that the weight of reason and authority is to the contrary.

The gist of the objection to the doctrine contended for by Appellant is well stated in the form of a rhetorical question in the case of Harvey v. Crane (U. S. Circuit, Ill.), Fed. Case No. 6178:

> "Can the creditors keep their business and supposed securities in their pockets, and permit their debtors to go on and do business as owners of the property and as soon as trouble threatens, watch their op-

portunity and sweep away all, simply by taking possession?"

In addition to the cases which we have above quoted we call the Court's attention to the following well-considered cases all holding the law to be as contended here:

Stephens v. Perrine, N. Y. 39 N. E. 11 (decided by Mr. Justice Peckham);

In re Morrill, 2 Sawy. 356, Fed. Case No. 9821;

Crooks v. Stuart (U. S. Circ. Ct. Ia.), 7 Fed. 800;

Smith v. Ely (U. S. Cir. Court N. Y.), Fed. Case No. 13,044;

Stein v. Munch, 24 Minn. 390;

In re: Foster, Fed. Case No. 4964;

Chapman v. Sargent (Colo.), 40 Pac. 849;

Second National Bank v. Hunt, 11 Wall. 391;

Allen v. Massey, 17 Wall. 351.

In the case of Robinson v. Eliot, 22 Law. ed. 758, 22 Wall 513, the facts were similar to those under examination here in that the mortgagee took possession before bankruptcy and the mortgage was held invalid at the suit of the trustee, the court holding that the subsequent transfer of possession did not render the transaction valid.

The one polar star to be observed throughout and

which will illuminate the fallacy of Appellant's argument in this and in every other respect is the word

"FRAUD"

and the whole principle with reference to the futility of a taking possession of what is left of a shifting stock of goods, after the mortgagor has been allowed to retain its custody and power of disposition and appropriate the proceeds of the part sold, is clearly and precisely expressed in the common law maxim:

Ex nihilo nihil fit.

* * * * * *

Under the subdivision

"(d) Even without a change of possession, an unrecorded mortgage given in good faith is good against every one but subsequent purchasers and mortgagees in good faith and for a valuable consideration of the same personal property,"

Appellant brings forward nothing which was not fully answered in our original Brief. The question of possession has been adverted to. We called attention to our original Brief to the language of Section 799 L. O. L. which renders a transaction of this character invalid not merely as to subsequent mortgagors but as to creditors generally where the possession continued in the mortgagor and in this case it contained until the eve of bankruptcy, and the inference results that the debts to the creditors represented by the trustee were not incurred subsequent to the change of possession.

Nor has this presumption of fraud been removed as Appellant assumes. Rather it has been indelibly stamped upon the transaction by the incidents already so often referred to.

* * * * * *

The only other question in this case is that discussed by Appellant under

III.

The Authority of the Trustee to Maintain this Suit.

In arguing the right of the Trustee to attack the mortgage here we referred to the somewhat analogous right asserted by the Supreme Court of Oregon in Jacobs v. Ervin, 9 Ore. 52, to inhere in the assignee at Common Law or under State Insolvency laws.

The Appellant quotes from the case of Hahn v. Salmon, 20 Fed. 807, That case did not in any wise involve the setting aside by an Assignee of a fraudulent chattel mortgage but was an attack upon the assignment itself by the attaching creditor. That opinion is also quoted by the Appellant to the effect that inasmuch as an insolvent debtor who has made a fraudulent transfer of his property cannot reclaim it, *he* cannot confer such a right on another; i. e., an assignee. Possibly not, but the *law can,* and precisely this right is conferred on the Trustee by Section 70 (a) 4 of the

Bankruptcy Act of 1898, which specifically endows the trustee with the *title to "property transferred by him (the bankrupt) in fraud of his creditors."*

Gammons v. Holman, 11 Ore. 284, next cited by Appellant was to the effect merely that an assignee could not attack the possession of one who had received personal property from the debtor in *good faith,* as security for advances. It was there said that the assignee took the legal title and no more and acquired the rights of the assignor. No question of a creditor's right was then in issue; indeed no creditor could have successfully attacked Holman & Co., *for the reason that there was no fraud.* Helms v. Gilroy, 20 Ore. 517, is to the same effect.

Appellant then cites Fisher v. Kelly, 30 Ore. 1, in which it is said that a mere general creditor cannot raise the question of the invalidity of a chattel mortgage. At page 36 of its Brief Appellant asserts that these cases sufficiently answer our "claim that a general creditor could impeach a transaction between Sondheim and the Bank." Appellant thus valiantly assails windmills. We assume that Appellant would hardly deny the right of the State or of the United States to endow the Trustee with authority which it denied to a mere general creditor. And *that authority has been specifically conferred in transactions in which a taint of fraud inheres by Section 70 (a) 4* which by conferring title on the trustee to property fraudulently aliened necessarily endows him with power to assert that title by appropriate remedies.

Again, Section 70 (e) of the Bankruptcy Act explicitly provides:

> "The Trustee may avoid any transfer by the bankrupt of his property which any creditor of such bankrupt might have avoided, etc."

Here again, it must be borne in mind that the Trustee since the 1910 Amendment of Section 47 (a) is not merely a general creditor but is a *judgment creditor.* The inquiry then is would a judgment creditor have the right to attack a mortgage declared by the state law and adjudication to be fraudulent, and void as to creditors? The question answers itself. Assuredly a judgment creditor by virtue of a creditor's bill or other appropriate remedy, has a standing in Court to attack and set aside a fraudulent conveyance.

Appellant recurs to the Flatland case, 196 Fed. 310, and has the hardihood to assert "precisely the same situation exists in this case." We have before pointed out that no question of fraud arose in the Flatland case, the invalidity was claimed to inhere merely in a formal defect—recordation. (Even as to this *quaere*—whether or not the Flatland case has been impliedly departed from—in line with the holding in the other circuits—by the case of Pacific State Bank v. Coates (9th Circuit), 205 Fed. 618.) There is not a line in the Flatland directly or indirectly, denying or bearing on the right of the trustee to assail a *fraudulent* conveyance. Indeed the opinion quotes with implied approval the decision of the Supreme Court of the United States in the case of Yeatman v. Savings Institu, 95 U. S. 764, to the effect that while the trustee takes the title of the bankrupt subject to equities, *yet an exception exists* "in

cases where the disposition of the property of the bankrupt is declared by law to be fraudulent and void," and this is just such a case under the laws and decisions of the State of Oregon in which this transaction occurred.

The books teem with cases thus construing section 14 of the Bankruptcy Act of 1867 which like Section 70 (a) 4 of the Act of 1898 vests in the trustee title to property conveyed by the bankrupt in fraud of his creditors, and these cases apply the provision definitely and specifically to transactions identical with that at bar, i. e., mortgages which under their terms or in operation permit the mortgagor to retain and dispose of all or a part of a shifting stock of merchandise, nominally covered by the mortgage. Many of these cases have been cited hereinbefore in other connections and will not now be repeated.

We will quote from only one of these: Edmondson v. Hyde, Fed. Case No. 4285, decided by Circuit Judge Sawyer, in which an unusually full and clear discussion of the matter occurs. Said that Judge *inter alia*:

> "What does this phrase, 'in fraud of his creditors' mean? Can it be limited to property conveyed with a specific intent to defraud creditors, or is it to be extended to conveyances in fraud of creditors in the technical and legal sense of the term? Upon what principle can the construction be limited to the former class? * * *
>
> "A party who mortgages a stock of goods for example, and yet retains possession, controls and sells them, and surrounds them with all the indicia of owner-

> ship in himself, lulls existing creditors into a false security, and induces others to credit him on the supposition of his ownership, thus working actual fraud, whether so specifically intended or not. This result having been found in practice to be so common, the dictates of good policy suggested that the law should, in all cases, declare that to be fraudulent in contemplation of law, regardless of any specific intent, which was ordinarily found to be so in fact."

See also in re: Werner, Fed. case No. 17,416 (Judge Dillon).

Second National Bank v. Hunt, 11 Wall. 391, was a contest between the trustee in bankruptcy and the mortgagee under a shifting stock mortgage, who had taken possession as in the case at bar, and the trustee prevailed.

So Robinson v. Elliott, 22 Law Ed. 758, was likewise a case in which a mortgagee under a shifting stock mortgage took possession before bankruptcy, but the trustee prevailed.

See also Allen v. Massey, 17 Wall. 351.

And we again invite the Court's attention to the well reasoned case of Mitchell v. Mitchell, erroneously cited in our original Brief as 12 A. B. R. 389 (instead of 17 A. B. R. 382), 147 Fed. 208.

In view of the quotation by Appellant from Collier and from Black in other connections the Court may be interested in the views of these text writers on this particular subject:

"But more than this, the act provides * * * (Sec. 70a) that the trustee shall be vested with title to property conveyed by the bankrupt *in fraud of his creditors.* As to such property therefore, the trustee is not merely a successor to the rights of defrauded creditors, but he is invested with the *title,* and may sue to vacate or avoid any fraudulent transfer of the bankrupt's property *whether or not there is any creditor armed with a lien or otherwise in a position to attack such transfer.*" Black on Bankruptcy, Sec. 446, p. 979, 980.

"It is immaterial that the creditors of the bankrupt were not in a position to attack the transfer."

Collier on Bankruptcy, p. 1042e.

"Such a suit may be maintained although neither the trustee nor any creditor has reduced the claim to a judgment. To hold that a trustee cannot attack a fraudulent conveyance made by a bankrupt more than four months before the filing of the petition without showing that some creditors had obtained a judgment and issued execution thereon, so that he could maintain a similar action would be simply to provide an easy and convenient method for a dishonest debtor to dispose of his property." Ib. p. 1042f.

* * * * * *

Mr. Collier in this connection cites the case of Thomas v. Roddy (N. Y.), 19 A. B. R. 873, and Sheldon v. Parker (Neb.), 11 A. B. R. 152.

In the former case the Court passing upon the right of the trustee to attack a conveyance on the ground that

it was in fraud of the creditors cites as its authority for sustaining such an action, Section 70 (a) 4 of the Bankruptcy Act endowing the trustee with title to property transferred by the bankrupt in fraud of his creditors. The Court considers in this connection Section 70e, which contains the further proviso that the trustee may avoid any transfer by the bankrupt which any creditor of the bankrupt could have avoided and the Court holds that the trustee by virtue of Section 70 (a) 4 is clearly invested with the title of property transferred by the bankrupt in fraud of creditors unless that right should be held to be restricted by subdivision (e) of the same section, which restriction the Court said it did not believe existed, the opinion continuing:

> "The policy of the Act is to secure an equal distribution of all property of the bankrupt among his creditors. For that purpose the trustee represents all the creditors and may maintain an action to set aside any transfer which any creditor could or which any creditor might acquire by any process taken by him. * * *
>
> "Under the Bankruptcy Act of 1867, which contained a provision to the effect that title to property fraudulently transferred vested in the assignee, now the trustee, it was held that the assignee could maintain an action to set aside such transfers whether any individual creditor could have done so or not. Platt v. Matthews, 10 Fed. 280; Matter of Leland, 10 Blatchf. 503. Judge Wallace, who delivered the opinion in the Matthews case, concluded by saying:

> " 'Numerous other authorities might be cited to sustain the position that an assignee may proceed to recover property transferred in fraud of creditors whether any creditor was in a position to attack the transfer or not, and that his title accrues by force of the act, and not through the rights of the creditor to assert the fraud.' "

* * * * * *

In conclusion we submit that assuming the intent and spirit of the Bankruptcy law to be to preserve a parity among the creditors, to ratify and confirm so far as may be, the law and practice of the particular state, with reference to the validity of liens and bona fides of mortgage transactions, transfers and other conveyances; keeping in view the fact that the State of Oregon has more strongly perhaps than any other state, condemned as utterly and hopelessly fraudulent a transaction like the present, in which a shifting stock of goods is covered by a secret mortgage kept from the records, and by the very terms of the agreement the mortgagor is given the right inconsistent with any honest mortgage, of retaining one-half of the proceeds of the goods of which is he permitted to dispose, and when beyond that, in actual practice, the mortgagee does not even insist upon the payment to it of one-half of the proceeds, but makes a subsequent and different arrangement, not in writing, and also not recorded by which it is to receive a certain sum per week, regardless of the amount of the mortgaged property which may be sold; and where this course of conduct is continued until the eve of bank-

ruptcy when writs of attachment have been issued, and the mortgagor is a fugitive when the mortgagee quietly slips an agent into possession—to contemplate a transaction of this character and argue it immune, under any theory, from attack by the trustee appointed to protect the rights of the creditors, and assail fraudulent conveyances, and armed for that purpose by the law itself, with title to property fraudulently conveyed and given also the rights of a judgment creditor, produces necessarily a sensation of logical revulsion.

Such a result must be the product of sheer sophistry and that sophistry is apparent at every stage of Appellant's argument, and his conclusions are reached by the false assumption that the mortgage is only presumptively void and not void as a matter of law, despite decision after decision expressly declaring the reverse to be true; by the false assumption that a proceeding in the way of a subsequent taking of possession of what is left of the mortgaged property after the harm has been done, gives life and respectability to the void instrument although the decisions in this jurisdiction and the weight of reasoning and authority elsewhere, including the United States Supreme Court, pronounces the reverse to be true; by the false assumption that conceding the invalidity, yet the intervention of bankruptcy proceedings designed to put a stop to just such looting, has the effect of denying a remedy to those who have been wronged, upon which phase Appellant is equally insistent, despite the plain provisions of the Act, the decisions of the courts, and the views of text writers who have made the subject a life study.

We earnestly believe that this court will not adopt views rendering the Bankrupt Act so futile and actually harmful a species of legislation.

Respectfully submitted,

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